

DISCLAIMER

This electronic version of an SCC order is for informational purposes only and is not an official document of the Commission. An official copy may be obtained from the [Clerk of the Commission, Document Control Center](#).

COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

At Richmond, MARCH 28, 2000

APPLICATION OF

VIRGINIA ELECTRIC AND POWER
COMPANY

CASE NO. PUE990717

To revise its fuel factor pursuant
to Va. Code § 56-249.6

FINAL ORDER

On December 21, 1999, Virginia Electric and Power Company (“Virginia Power” or the “Company”) filed an application, testimony, and exhibits in support of an increase in its fuel factor from 1.152¢/kWh to 1.339¢/kWh, effective for usage on and after February 1, 2000. The proposed fuel factor would result in an increase in annual fuel revenues of approximately \$104 million.

Virginia Power's application contained the direct testimony of Kurt W. Swanson, Daniel J. Green, Charles A. Stadelmeier, William R. Eckroade, and Harrison H. Barker. The Company stated that its testimony and exhibits demonstrated that a revision in the current fuel factor was necessary to provide Virginia Power the appropriate level of fuel expense recovery over the period of February 1, 2000, through January 31, 2001.

By Order issued December 29, 1999, the Commission established a procedural schedule and directed Staff to investigate the reasonableness of the Company's projected fuel expenses and fuel factor and to file a report on its investigation on or before February 4, 2000. The Commission noted that the instant application raised three issues of first impression: (i) the consideration of off-system sales in light of the Company's retail access pilot program; (ii) the Company's fuel costs incurred in replacing the power that had previously been purchased

through the Merom and Rockport long-term contracts; and (iii) the determination of the proper fuel expenses attributable to the Chaparral (Virginia) Inc. special contract. The Commission stated that, due to the complexity of these issues, a hearing would be scheduled for February 17, 2000, and that the Commission would allow the fuel factor to be placed into effect on an interim basis, beginning with usage on and after February 1, 2000. The Commission provided an opportunity for any person desiring to participate as a Protester to file with the Clerk on or before January 27, 2000, a Notice of Protest, Protest, and any prepared testimony and exhibits the Protester intended to present at the hearing.

On January 27, 2000, the Virginia Committee for Fair Utility Rates ("Virginia Committee") filed a Motion for a One-Week Extension to file its Protest and prepared testimony and exhibits, explaining that additional time was needed because of inclement weather.

By Order dated January 27, 2000, the Commission granted the Virginia Committee's request for an extension. The Commission extended the deadline for the filing of Protests and testimony and exhibits from January 27, 2000, to February 3, 2000. The Commission also extended the deadline for the filing of Staff's testimony from February 4, 2000, to February 7, 2000.

On February 3, 2000, the Virginia Committee filed a Protest and the prepared testimony of Ali Al-Jabir.

On February 7, 2000, Staff filed the prefiled testimony of Jarilaos Stavrou, Howard M. Spinner, and Michael W. Martin.

On February 11, 2000, Virginia Power filed the rebuttal testimony of E. Paul Hilton and Kurt W. Swanson.

The hearing was held on February 17, 2000, before the Commission. Edward L. Flippen, Esquire, and Kodwo Ghartey-Tagoe, Esquire, appeared on behalf of Virginia Power; Louis R. Monacell, Esquire, and Robert M. Gillespie, Esquire, appeared on behalf of the Virginia Committee, and M. Renae Carter, Esquire, appeared on behalf of the Commission's Staff. On

March 9, 2000, post-hearing briefs were filed by the Virginia Committee, Virginia Power, and the Commission's Staff.

Because Virginia Power's rebuttal testimony and post-hearing brief respond primarily to the arguments raised by the Virginia Committee, we will discuss the Virginia Committee's position first.

The Virginia Committee's Position

By its prepared testimony and post-hearing brief, the Virginia Committee raises two primary arguments; i.e., that Virginia Power should be required to: (1) flow 100% of margins from off-system sales, except for displaced pilot sales, through the fuel factor; and (2) provide the same fuel cost accounting treatment for sales under the Real Time Pricing ("RTP") Schedule as is provided for sales under the Chaparral (Virginia) Inc. ("Chaparral") Special Contract for Electric Service.

First, the Virginia Committee contends that after the first 50% of margins from off-system sales has been credited against fuel factor expenses, the remaining 50% that in the past had been assigned to offset deferred capacity expenses should flow through the fuel factor to offset fuel costs. The Virginia Committee argues that Virginia Power has incorrectly interpreted the settlement reached in Case Nos. PUE960036 and PUE960296 (henceforth, "Stipulation"),¹ which terminated the deferred capacity account, to allow the Company to include the remaining 50% of its off-system sales margins in the Company's earnings calculations that must be performed under the terms of the Stipulation. The Virginia Committee states that there is no provision in the Stipulation that addresses the fuel factor treatment of off-system sales, and the Stipulation explicitly provides that it does not affect the Commission's authority over regulatory requirements, except as provided in the Stipulation. The Virginia Committee contends that

¹ The Stipulation required, among other things, that \$220 million of regulatory assets be written off by the end of the rate period ending February 28, 2002. The first regulatory asset required to be written off, as of March 1, 1998, was the Capacity Deferral Balance of \$61.1 million. See *Virginia Electric and Power Company 1995 Annual Informational Filing*, Case No. PUE960036, and *Commonwealth of Virginia at the relation of the State Corporation Commission, Ex Parte: Investigation of Electric Utility Industry Restructuring--Virginia Electric and Power Company*, Case No. PUE960296, 1998 Ann. Rept. 322.

because no fuel issues were involved in Case Nos. PUE960036 and PUE960296 or were addressed in the Stipulation, the treatment of the 50% of off-system sales margins that previously were applied to the deferred capacity account is a policy issue that is properly before the Commission in this case. Further, the Virginia Committee contends that, consistent with the Commission's intent expressed in a prior fuel factor case,² the Commission should require the Company to credit 100% of its off-system sales margins to the fuel factor to the benefit of the Company's ratepayers. The Virginia Committee adds that Virginia Power's practice of applying the remaining 50% of the margins to its earnings creates an incentive for the Company to favor sales into the competitive off-system market as opposed to sales to native load customers.

Second, the Virginia Committee contends that Virginia Power should account for its fuel expense associated with RTP sales in the same way it accounts for its Chaparral sales. The Virginia Committee states that Virginia Power includes incremental fuel costs associated with RTP sales in calculating the fuel factor but credits only the average fuel factor revenues against such sales. Noting that incremental fuel costs typically are higher than system average fuel costs, the Virginia Committee contends that because the Company collects fuel expenses from RTP customers in excess of the system average fuel revenues, the Company's accounting treatment for RTP sales, in effect, artificially increases its fuel cost under-recovery at the expense of the Virginia customers who pay Virginia Power's Fuel Charge Rider A, thereby resulting in the double-recovery of some of the Company's fuel costs. The Virginia Committee acknowledged that it is raising the RTP incremental fuel revenue adjustment for the first time in this case because it had not focused on the mismatch of the Company's imputation of average fuel factor revenue in the past.

Virginia Power's Position

The Company's rebuttal testimony and post-hearing brief address the Virginia Committee's arguments that the Company should be required to credit 100% of the off-system

² *Application of Virginia Electric and Power Co.*, Case No. PUE950094, 1995 S.C.C. Ann. Rept. 363.

sales margins to the fuel factor and that RTP sales should be subject to the same fuel factor treatment as sales to Chaparral.

First, Virginia Power opposes the Virginia Committee's recommended treatment of off-system sales, arguing that it has no legal or economic justification. The Company contends that because the Stipulation required that the deferred capacity account be written-off as of March 1, 1998, and established how the Company would apply its earnings during the rate period covered by the Stipulation, the 50% of off-system sales margins not credited to the fuel factor now is part of the overall cost of service and is included in the Company's earnings test. Virginia Power notes that its witness, Mr. E. Paul Hilton, who was involved in the discussions resulting in the Stipulation, testified that during those discussions the parties all understood that the margins from off-system sales previously applied to the deferred capacity account were in the revenues that were considered in setting the rates, refunds, and rate reductions, and in determining the amount of regulatory assets the Company would be required to write-off pursuant to the Stipulation.³ The Company argues that to remove the portion of the off-system sales not credited against fuel expenses from the Company's earnings would reduce the amount of total earnings available to write down regulatory assets, a result not intended by the Stipulation.

Second, Virginia Power addresses the Virginia Committee's argument that Schedule RTP sales should be accorded the same fuel factor treatment as sales to Chaparral. The Company maintains that its present fuel factor treatment for RTP sales is reasonable. Virginia Power states that the majority of Schedule RTP sales are the result of RTP customers transferring their purchases from the companion GS rate schedule (GS-3 or GS-4) to Schedule RTP, and that these customers are limited to transferring up to 20% of their existing purchases to the RTP Schedule. The Company contends that there is no justification to change from average to incremental fuel costs simply because a customer purchases its electricity on a different rate schedule. Virginia Power states that RTP sales continue to be supplied from a proportionate mix of all the

³ Virginia Power Post-hearing Brief at 7-8.

company's units, and therefore RTP fuel factor accounting should remain the same; i.e., based on average fuel cost. Rebutting the Virginia Committee's contention that the Company will double recover some fuel costs if it does not adopt a fuel accounting treatment for RTP customers based on incremental costs, Virginia Power states that revenues received from the RTP Schedule "in excess" of average fuel costs are applied to Virginia Power's base revenues.

Staff's Position

Staff finds that the Company's assumptions underlying the proposed fuel factor are reasonable and recommends that the Commission approve the continuation of the currently-operative total fuel factor of 1.339¢/kWh, effective with usage on and after February 1, 2000. In addition, Staff discusses certain issues that it believes warranted special consideration.

The first issue involved the determination of the proper fuel expenses attributable to the Chaparral sales. Staff expresses concern that the Company's proposed use of the projected hourly system lambda to approximate Chaparral fuel costs will result in a biased estimate of the marginal fuel costs to supply Chaparral's load, thereby increasing the amount of fuel expenses that would have to be collected from other Virginia jurisdictional ratepayers. Staff states that it intends to monitor and evaluate the Company's proposed methodology, and will explore alternative ways to identify Chaparral fuel costs more precisely.

Second, Staff discusses the treatment of off-system sales margins associated with the sale of power that will become available when customers who will participate in the Company's retail access pilot program elect to purchase their power from an alternative generation supplier. Staff agrees with Virginia Power that the Company should be able to retain all of the off-system sales margins associated with these "displaced pilot sales," and that the energy revenues associated with these sales should be credited against the fuel factor in an amount equal to the average fuel factor cost. Staff points out that the difficulty with this proposal is how properly to determine which off-system sales are associated with departed retail load in the pilot program. Staff requests that the Commission direct Virginia Power to work with Staff to develop a proper method for determining which off-system sales represent displaced pilot sales.

Staff also discusses the Company's use of a new forecasting model ("PROSYM") to forecast Virginia-allocated energy margins derived from off-system sales, and requested that the Commission order the Company to provide documentation and a demonstration of the PROSYM forecasting model to Staff and explain the assumptions, parameters, and data used to run the models. Staff recommended that in future fuel factor proceedings, the Company should be required to estimate the magnitude of energy sales "displaced" due to customers choosing alternative generation suppliers, and to adjust its forecast of energy sales as appropriate. Staff also pointed out that, due to changes in state law related to electric utility restructuring, as of January 1, 2001, corporations that use electricity to furnish heat, light or power will no longer be subject to gross receipts taxes, and that it is important that all electric utilities collecting such taxes through a fuel factor remove the gross receipts tax from customer bills at the appropriate time.

Staff takes no position on the Virginia Committee's claims. Staff states that it believes the issues raised by the Virginia Committee may warrant consideration at the expiration of the Stipulation period (i.e., February 28, 2002). Regarding the determination of fuel expenses associated with sales made under the Chaparral Agreement, Staff states that it will continue to monitor the method by which Virginia Power quantifies these fuel costs and to examine alternative methods for deriving these costs. Staff urges the Commission to require the Company to work with Staff to arrive at a method for quantifying fuel costs related to serving Chaparral and for identifying displaced pilot sales and the associated margins.

NOW THE COMMISSION, upon consideration of the record in this case, is of the opinion that Virginia Power's proposed fuel factor of 1.339¢/kWh is appropriate based on its projected fuel expenses. Approval of this factor, however, is not to be construed as approval of the Company's actual fuel expenses. For each calendar year, the Commission's Staff conducts an audit and investigation that addresses, among other things, the appropriateness and reasonableness of the Company's booked fuel expenses. Staff's results are documented in an Annual Report ("Annual Report"). A copy of the Annual Report will be sent to the Company

and each party who participated in the Company's last fuel factor proceeding, all of whom will be provided an opportunity to comment and request a hearing on the report.

Based on Staff's Annual Report, and any comments or hearing thereon, the Commission enters an Order entitled "Final Audit for Twelve-Month Period Ending December 31, 20__, Fuel Cost-Recovery Position," hereinafter referred to as "Final Audit Order." Notwithstanding any findings made by the Commission in an earlier order establishing the Company's fuel factor based on estimates of future expenses and unaudited booked expenses, the Final Audit Order will be the final determination of not only what are in fact allowable fuel expenses and credits, but also of the Company's over- or underrecovery positions of the end of the audit period. Should the Commission find in its Final Audit Order (1) that any component of the Company's actual fuel expenses or credits has been inappropriately included or excluded, or (2) that the Company has failed to make every reasonable effort to minimize fuel costs or has made decisions resulting in unreasonable fuel costs, the Company's recovery position will be adjusted. This adjustment will be reflected in the recovery position at the time of the Company's next fuel factor proceeding. We reiterate that no finding in this order is final, as this matter is continued generally, pending Staff's audit of actual fuel expenses.

We will not adopt the Virginia Committee's proposed adjustments to the fuel factor discussed above. The Stipulation was the result of extensive discussions and a thorough analysis by the parties in that case, including the Virginia Committee, of a number of significant and complex rate and allocation issues. The resulting Stipulation was a balance that required the Company to provide refunds, to reduce its rates over a five-year period, and to write-off regulatory assets of no less than \$220 million.

Negotiation of the Stipulation required certain concessions by the Company and the other parties to reach a compromise each party would find acceptable. On one hand, the Company assumed the risks that existing costs reflected in the base rates might increase and new costs might be incurred. Since Virginia Power's rates were "frozen" for the duration of the rate period, base rates could not be adjusted to recover such costs. On the other hand, the Company's

customers assumed the risks that the Company's costs would decline without a concomitant decrease in base rates. When we approved the Stipulation in 1998, we realized the Stipulation entailed concessions by the various parties and posed potential risks and rewards for both the Company and its customers. In our judgment, the Stipulation represented a careful balancing of these potential outcomes. Given the record in this case, we find it would be inconsistent with the Stipulation and fundamentally unfair to adopt the Virginia Committee's proposed adjustments to the fuel factor at this time.

Turning to the matter of Chaparral's fuel expenses, we will direct our Staff to continue to investigate methods for quantifying fuel costs associated with the Chaparral sales, and to file a report on its findings and recommendations on or before July 1, 2000. The Company shall assist and cooperate with the Staff. This issue will be addressed in the Company's next fuel factor case.

Finally, we will adopt the Company's proposed revision to the Definitional Framework of Fuel Expenses.⁴ This revision to the Definitional Framework of Fuel Expenses is necessitated by the retail access pilot program which the Company has developed at the direction of the Commission in Case No. PUE980813. We will direct our Staff to propose a method for identifying those off-system sales that result from the departure of retail customers who choose an alternative generation supplier and the margins associated with such sales, and to file a report on its findings and recommendations on this matter on or before September 1, 2000. The Company shall assist and cooperate with the Staff. This issue will be addressed in the Company's next fuel factor case. Accordingly,

IT IS ORDERED THAT:

⁴ The Company proposes adding a clause stating:

During the Retail Pilot Program, the Company shall be permitted to credit energy revenues associated with Displaced Pilot Sales against fuel factor expenses in an amount equal to the average fuel factor. No energy margin associated with the sale of the Displaced Pilot Sales should be credited against fuel factor expenses.

(1) The total fuel factor of 1.339¢/kWh, effective for usage on and after February 1, 2000, established by the Commission Order of December 29, 1999, remains in effect.

(2) The proposed revision to the Definitional Framework of Fuel Expenses is hereby adopted, as discussed in the Order.

(3) The Commission's Staff shall conduct an investigation regarding methods for quantifying fuel costs associated with the Chaparral sales and file a report on its findings and recommendations on or before July 1, 2000.

(4) The Commission's Staff shall develop a method to identify those off-system sales that result from the departure of retail customers who choose an alternative generation supplier and the margins associated with such sales, and file a report on its findings and recommendations on or before September 1, 2000.

(5) The Company is hereby directed to make arrangements with the Commission's Staff to provide documentation and a demonstration of the PROSYM forecasting model and to explain the assumptions, parameters, and data used to run the models, within a timeframe deemed appropriate by Staff.

(6) This case shall be continued generally.